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The Effect of Corporate Social Responsibility (CSR) on Banks' Financial Performance: A Case Study on Saudi Banks

Tariq Saeed
Correspondent Author
Department of Information Science
College of Computer Science & Engineering
Taibah University, Madinah Almunwarah, Saudi Arabia
E-mail: tmian@taibahu.edu.sa

Musaed Sulaiman AlAli
Department of Insurance and Banking, College of Business Studies
The Public Authority for Applied Education and Training (PAAET), Kuwait
E-mail: ms.alali@paaet.edu.kw

Abstract

This study aims to examine the effect on corporate social responsibility (CSR) on the financial performance of Saudi banks over the period expanding from 2014 to 2019. Using a panel date regression, results show that the amount of Zakat, CSR proxy, and Zakat to net income ratio had a statistically significant and positive effect on Saudi banks financial performance measured by return on equity (ROE). This would indicate that bank business tends to be more profitable and customer become more loyal when the bank engages in CSR activities in the community.

Keywords: Corporate Social Responsibility (CSR), Saudi Banks, Panel Data Regression, Return on Equity (ROE), Financial Performance.

1. Introduction

Since Bowen's (1953) book on the social responsibilities of businesses, corporate social responsibility (CSR) has been a hot topic both in business and academic environments. In general terms, CSR is perceived as the obligations of firms to contribute and improve welfare of society through different practices and applications for sustainable benefits to all stakeholders (Turban and Greening, 1997; Staples, 2004; Sen and Bhattacharya, 2001). As a socially and environmentally respected government body, the European Commission has focused more on the importance of CSR and has defined it as "*a concept whereby companies integrate social and environmental concerns in their business operations and their interaction with their stakeholders on a voluntary basis*". The Commission later extended the definition to include ethical, consumer and human rights concerns into business strategy and operations of firms (European Commission, 2019).

Firms are expected to work closely with their stakeholders while maximising the share value of their shareholders and preventing possible adverse impacts of their business activities. In other words, the key principle idea behind CSR is that firms need to take into account the needs of a broader range of stakeholders (Waddock et al., 2002). CSR aims to ensure that, while the firm maximises its value for its shareholders, it should exhibit a positive attitude toward social, environmental, ethical, commercial, legal, and public expectations of the society that it operates in.

The literature categorised the approaches to CSR into four main groups: (1) maximising profit and value of firms, (2) using business power socially responsibly, (3) incorporating social demands, and (4) perceiving social responsibility as an ethical responsibility (Carroll, 1979; Garriga and Mele, 2004; Mele, 2008; Carroll and Shabana, 2010).

The first approach claims that the sole responsibility of a corporation is wealth creation. It allows only the economic aspect of an interaction between a corporation and society. In this approach, CSR is accepted as long as it is a strategic instrument to achieve profit maximising objectives and value creation. Because of this, the approach is also called instrumental approach (Garriga and Mele, 2004). A notable and well-known advocate of this approach is Milton Friedman, who was an economist and a notable philosopher of the 20th century. He says that firms should only do their business and the only social responsibility of firms is to increase their profits as long as they stay in the business (Friedman, 1970). Similarly, and earlier, Theodor Levitt claimed that corporate social responsibility makes good sense as long as it economically makes good sense which it often does not do (Levitt, 1958). This approach view firm profit and efficiency would be negatively impacted from corporate social responsibility activities as these activities don’t have direct contribution to a firm’s business objectives.

Contrary to this argument, Frooman (1997), Griffin and Mahon (1997), Key and Popkin (1998), Roman et al. (1999), and Waddock and Graves (1997) have established a positive correlation between long-term firm performance and corporate social responsibility activities while short-term profit maximisation might still contradict with CSR. Therefore, if a firm objective is to build a long-lasting business, corporate social responsibility could be perceived as a tool to achieve this goal. In this respect, CSR could give a competitive advantage to these firms (Porter and Kramer, 2002) for the long-term profit and value maximisation of the firm. However, as Burke and Logsdon (1996) point out, not all CSR practices are profitable. They suggest that firms should carry out CSR practices that contribute, or have the potential to contribute to the business objectives of a firm.

The second approach focuses on the role of social power of corporations in the relationship between corporations and society and the responsibility of corporations in the political environment. This approach stresses relationship between business environment and society and points out the importance of the power and the position of corporations along with their responsibilities (Davis, 1960). This approach assumes that not only internal but also external factors contributes to the social power of the business, and power requires responsibility. Therefore, businesses need social acceptance to continue benefiting from external factors and, apart from wealth creation and short- and long-term profit, firms should feel responsible for social problems directly or indirectly created by businesses or other causes and should use their power responsibly (Davis, 1960; Preston and Post, 1975). These are beyond their economic or legal responsibilities and they stem from both the existence and the size of social power they possess.

Donaldson (1982) claims that a social contract exists between business environment and society. Because of this contract, business environment has some indirect responsibilities to the society. Some proponents of this approach introduced the “corporate citizenship” concept to emphasise the responsibilities of firms to their communities (Andriof and McIntosh, 2001; Matten and Crane, 2005). While the concept has a narrower implication compared to CSR, it stresses responsibilities of business towards societies they operate in and willingness to contribute these societies and their environments.

Integrating social demands into business strategy for business continuity, growth and even existence constitutes the base for the third approach, which is also labelled as the stakeholder approach (Freeman, 1984). The stakeholder approach assumes the relationship of a firm with a wider range of stakeholders including shareholders, employees, customers, suppliers, investors, the neighbourhood of firm, and the environment. It suggests that firms should consider the effects of their business activities on all these stakeholders and should monitor and preserve the interest and rights of all these agents. This approach claims that without stakeholders, businesses do not exist and the stakeholders give legitimacy and prestige to business. Therefore, in order for the survival of their business, business entities should be operated for the benefits of all stakeholders through integrating the social demands of their stakeholders (Evan and Freeman, 1988).

The main idea behind this approach is a mutual benefıt both for the business and the entire system of stakeholders. When a firm respect social and environmental issues and take into account all of them, then it would maintain a high level of cooperation between these stakeholders and the benefits of the firm. This would be beneficial to the brand image of the firm, reduce possible risks of CSR activity failures, the consequences of which could be very detrimental to the firm (Emshoff and Freeman, 1978). Therefore, following this approach, firms are expected to achieve and maintain a long-run sustainable growth profile and display a positive firm performance. In this sense, this approach is similar to the instrumental approach. However, a firm achieve all these business objectives while being beneficial to its all stakeholders.

The last approach puts the spotlights on the ethical values. It suggests that ethical values should shape the relationship between corporations and the society and corporations should use ethical values as their benchmark when implementing social responsibility activities. The approach focuses more on the ethical side of CSR activities than its profit-generating features. In other words, motivated by ethical concerns, business entities might not always generate profit from their CSR activities. If there is a conflict between a firm's economic interests and ethical considerations, the ethical considerations should, at least in some cases, outweigh economic interest. However, it should also be noted that ethical CSR doesn't always imply economic losses to firms, it rather implies that proceeding with an ethical approach to CSR over pure economic interest leads firms to accept possible losses of profit for moral reasons (Frederiksen and Neilsen, 2013).

The Kingdom of Saudi Arabia is known for its oil, it produces around 12.9% of the total global production which makes it the second largest oil producer in the world after the United States. Saudi Arabia is also a member of the G20. In recent years the Kingdom of Saudi Arabia started reforming its economy to reduce its dependence on oil as a main source of income, for that new laws were passed and part of these laws was aimed to increase the private sector involvement in the society. As a result of these new laws, according to Transparent Hands (2017), 78% of the Saudi organizations are now actively engaged in CSR corporate social responsibility and 75% of the CEO is Saudi Arabia have direct involvement in CSR corporate social responsibility. These community involvements by companies does not come without any financial cost, but never the less these involvements had some positive effects on these companies. Al-Ghamdi and Badawi (2019) surveyed 624 banking customers in Saudi Arabia and found strong positive relation between bank's CSR and customer satisfaction and loyalty. Al-Malkawi and Javaid (2017) studied the effect of Zakat, which is in Islamic law is the responsibility of those who have toward those who are in need (charity) and for maximizing the social welfare, as a proxy for CSR on the financial performance of 107 Saudi non-financial institutions over the period 2004-2013, found a strong positive relation between financial performance and CSR. Saleh et al. (2011) used the data of the largest 200 largest firms listed on Bursa Malaysia over the period 2000 to 2005 and found that there was a significant positive relation between CSR and the financial performance of these companies. They suggested that engaging in social activities for local firms can enhance the levels of financial performance. Maqbool and Zameer (2018) examined the effect of CSR on the financial performance of Indian banks, using the data of 28 commercial banks listed at Bombay stock exchange (BSE) over the period 2007-2016, they concluded that there was a strong positive relation between CSR and the financial performance of these banks.

On the other hand, Aras et al. (2010) used the data of 100 companies listed at the Istanbul Stock Exchange (ISE) to examine the relationship between CSR and Financial Performance over the period 2005-2007 and failed to find any significant relationship between them. Lee et al. (2013) used the data of U.S. restaurant companies that are listed in either the S&P 500 or the Russell 3000 indices over the period 1991 to 2009 to examine the relation between CSR and these companies financial performance. They concluded that there was no statistically significant relation between them. While, Cavacoa and

Crifo (2014) using companies data from 15 countries over the 2002–2007 period, found a negative relation between CSR and the return on assets (ROA).

2. Data and Research Methodology

Results of this study are based on the financial data of ten Saudi high street banks (Saudi Investment bank, Riyadh bank, Saudi Fransi Bank, Saudi British bank, Samba bank, Aljazira bank, Alrajhi bank, AlAhli bank, AlBilad bank, and Alinma bank) over the period 2014-2019. The data of the research were obtained from the annual reports of the banks that were downloaded from the banks websites. Following Al-Malkawi and Javaid (2017) return on equity (ROE) which is calculated as the net profit over shareholders' equity is used as proxy for financial performance and disclosed Zakat amount is used as CSR proxy. The empirical model used in this research is as follow;

$$ROE = \alpha + \beta_1 lnZ_t + \beta_2 ZNI_t + \beta_3 ZTA_t + \varepsilon \quad (1)$$

Where ROE is return on equity, lnZ is the natural logarithm of the Zakat amount, ZNI is the ratio of Zakat to net income, ZTA is the ratio of Zakat to total assets, α is the constant, β_{1-3} are the parameters for the independent variables and ε is the error term.

3. Empirical Results

Descriptive analysis, presented in table 1, shows that the average ROE for the banks stands at 11.45% with a standard deviation of 3.88%. While, Saudi banks spend 7.71% of their net income on CSR activities which represents 0.15% of their total assets. The skewness and kurtosis of the variables demonstrate that the data is normally distributed since according to Klein (1998) for data to be normally distributed, skewness value should be less than $\pm$ 3 and kurtosis should not exceed $\pm$ 10 and for that linear regression can be performed safely.

Table 1: Descriptive Analysis

	ROE	lnZ	ZNI	ZTA
Mean	11.45%	5.056	7.71%	0.15%
Standard Deviation	3.88%	1.286	5.56%	0.16%
Kurtosis	-0.182	-0.877	-1.548	6.159
Skewness	-0.210	0.152	0.276	2.234
Count	60	60	60	60

The correlation analysis is used to measures the strength and the nature of the relation between variables where it takes a value between -1 and 1. The correlation analysis can also be used to identify any multicollinearity in the data. Multicollinearity can cause unrealistically high standard error estimates of regression coefficients and in the end can cause false conclusion about the significance of independent variables in the model being evaluated. In this research, a threshold of 0.70 is used to identify multicollinearity. Using Pearson correlation matrix in table 2, it can be seen that the data set did not suffer from the issue of multicollinearity.

Table 2: Pearson Correlation Matrix

	ROE	lnZ	ZNI	ZTA
ROE	1			
lnZ	0.154	1		
ZNI	0.302	0.644	1	
ZTA	-0.112	0.620	0.686	1

By looking at the regression output presented in table 3, it can be seen that CSR has a small effect on the financial performance of Saudi banks since the adjusted R^2 is less than 0.50, but still it can be used to explain 39.1% of the variance in the financial performance of the banks since *Sig F* is 0. In examining the relation with the variables, it can be said that the amount of Zakat paid had a statistically significant direct relation with the financial performance of the banks which is in line with findings of Al-Malkawi and Javaid (2017). Zakat to net income ratio also showed a statistically significant direct relation with the financial performance of the bank. These results are in line with the majority of researches done in this area where they concluded that CSR would have a positive effect on the financial performance of companies and contradicts Aras et al. (2010), Lee et al. (2013), and Cavacoa and Crifo (2014) findings.

Table 3: OLS Regression Results

R Square	0.422		*Significance F*	0.000
Adjusted R Square	0.391			
Observations	60			
	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	0.028	0.020	1.379	0.173
lnZ	0.028***	0.005	5.481	0.000
ZNI	0.608***	0.114	5.340	0.000
ZTA	-3.705	3.785	-0.979	0.332

4. Summary and Concluding Remarks

There is no conclusive evidence about the impact of corporate social responsibility (CSR) on the financial performance of a company, this research aims to shed some light into that effect. This research was set to examine that effect of CSR on the financial performance of Saudi banks, using ROE as a measure for financial performance, results obtained from this research showed that CSR when taken both at the amount level and as a ratio of CSR to net income had a statistically significant positive effect on the financial performance of Saudi high street banks. The results of this research shows that banks engaging in corporate social responsibility (CSR) activities have a better financial performance than those who do not.

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